

How Brazil's taxes affect the **poor**

The Brazilian tax system does little, if anything, to reduce income inequality.

Solange Monteiro

BRAZIL'S HIGH TAX BURDEN is in the news every day. In theory, high taxes are necessary to pay for cash transfers aimed at reducing income inequality. However, these transfers have been less efficient than expected: it is estimated that less than one-third of the transfers actually reach the relatively poor. The remainder is the "tax-welfare churn": what the government takes from a taxpayer with one hand it gives with the other to the same taxpayer.

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as in 1960, 0.53, yet the tax burden is 17% of GDP. This means that today, although we mobilize more than twice the resources, we maintain the same degree of inequality," says Rozane Bezerra de Siqueira, economist at the Federal University of Pernambuco.

Siqueira compared the impact on household income at different stages of cash transfers (Family Grant, family wage, salary bonuses, unemployment insurance, and benefits to the elderly and disabled); direct taxes (income taxation of individuals and social security contributions); and indirect taxes (taxes on goods and services less subsidies). She found that social transfers reduce income inequality measured by the Gini by 6 percentage points; direct taxes reduce inequality further by 2 points; but indirect taxes increase inequality by 3 points. In sum, the impact of taxes on inequality is just 5 points. "In the UK, consumption taxes also increase inequality, by 4 percentage points, but the weight of transfers is higher, and total impact on inequality is 14 percentage points. In the European Union, transfers and taxes reduce inequality by 20 percentage points," she says.

Nora Lustig, professor at Tulane University in the U.S., is director of the Commitment to Equity

Project, which is analyzing the impact of taxes, transfers, and other public spending on inequality and poverty in 32 countries. She believes the most troubling issue in Brazil is the weight of indirect taxes on the basic consumer basket. “The taxes on consumption nullify the effect of cash transfers on poverty reduction,” she says.

Nevertheless, Lustig says, Brazil still redistributes more income than the Latin American average, through such nonmonetary transfers as free health and education services. Among emerging nations, only South Africa surpasses Brazil. But even with massive transfers, she says, Brazil remains one of the most unequal countries in the world.

Simple and clear

Because indirect taxes are regressive, they are often mentioned as a candidate for reform to increase the redistributive impact of the tax system. Siqueira, however, emphasizes that “indirect taxes account for a large part of the tax collection, 48%. To reduce indirect taxes would require increasing tax income [in other ways], which does not sound feasible.” Nor does she support tax exemption policies. “It is a difficult alternative for a complex tax system as Brazil’s, with different tax rates and tax collection systems, which also has ripple effects,” she says. She believes that the priority should be a broad tax reform that would create a value-added tax (VAT) with just a few rates, in order to bring simplicity and transparency to the system.

Since such a major change in the tax system is not feasible in the short term, Siqueira suggests a move to a more progressive tax system. José Roberto Afonso, IBRE researcher, recommends more selective indirect taxation. “The Constitution

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provides that the ICMS and IPI have different rates for essential goods,” he notes. “The problem is that the IPI was practically abolished and the ICMS is distorted by the tax war between Brazilian states. Most of the products involved in this war are not consumed by the poor.”

Afonso advocates a tax on assets as a way to reduce the burden of regressive taxes. He says the collection of property tax has lost ground to other taxes, such as those on services, which also burden the poor. He explains that “Mayors generally avoid unpopular increases in property taxes because they are already collecting a lot from the tax on services, which is a tax that people pay without noticing. What we do not say is that the property tax is fairer than the tax on services because properties of low value are exempt.”

There are other important issues that need to be evaluated. The first is the quality of public spending. “There is a huge lack of knowledge, and interest about who spends and how,” Afonso says. The second is the need to reform the pension system. Today, 15% of GDP goes to public assistance transfers and 11% to pensions. Siqueira believes that part of these funds should be directed to other purposes to achieve a larger redistributive effect, pointing out that “Investing in infrastructure contributes to sustainable growth.”

